

CURRENT ISSUES IN FOOD DISTRIBUTION

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Discusses in detail major current issues, other than productivity, that are facing the food industry.

My assignment, today, is to identify and briefly discuss some of the current issues in food distribution and the economy. I will not intentionally offer solutions although my biases may be obvious. The issues that I have chosen to include are:

1. Inflation - fears for its continuing and the impact on the 2nd issue of--
2. Capital availability for the food industry.
3. Well intentioned regulations for consumers' protection, sometimes not knowing where to stop.
4. Continued trend toward more food consumed away from the home.
5. Widely fluctuating commodity prices and the accelerated search for alternative food products and potential impact on the industry structure.
6. Recognition of food distribution as a system.
7. And our "legislative factory" and the need for politico-economic information.

Probably the issue receiving most attention from within the food

distribution industry is productivity. I have not included it in my list of issues only because the subject will be well covered by others on the program, who are much closer to current activities.

ISSUE 1. At the risk of sounding like a politician, inflation continues to hang as the black cloud, ready to engulf us at any moment. The two most susceptible areas are food and energy. Although, some of the pressure seems to have been lifted by the pricing weaknesses displayed in the OPEC cartel and by our bountiful grain harvest, past experiences are still too recent for the concerns to disappear.

For food specifically, it appears to me that the industry is destined for increased scrutiny and investigation. The question is who will catch the brunt of the attack and what form will the proposed corrective solutions take.

For example: If the weather cooperates and there is another large grain crop in 1976-77, and livestock production continues to expand, raw material costs (basic agricultural commodities) will decline at a time when other costs are going up - so that middle men margins will probably widen dramatically - leaving them as likely targets for "concerned" consumers and their representatives. The result may not only be to scrutinize the margin components but to rationalize added

regulations and restrictions in a variety of areas.

On the other hand, if planting and growing conditions are poor for the next crop (even beginning with the current winter wheat crop) we might expect escalating commodity prices as we move through the crop season - and the Presidential Election Campaign - this might be an "irresistable political opportunity". In this worst case scenario, a reimposition of some form of price controls could follow - either prior to the election or after it, as a result of the promises made during the heat of the campaign.

In either case, attention will be centered on the food manufacturing and distribution industry.

ISSUE 2. Of greater concern, however, should be the impact of continued inflation on the needs for and the availability of capital - in many cases the capital necessary for making productivity improvements. Probably the best analysis, and certainly the best presentation was made by Tom Wilson, McKinsey & Co. at the last SMI convention in Dallas.

He asked, why, as 1974 drew to a close, did the grocery industry find, compared to the end of 1972:

10 - 15% inflation vs. 3 - 4%

7 - 8% unemployment vs. 4.5%

4 consecutive quarters with no GNP growth vs. a real GNP growth of 4%?

Dow-Jones Industrial average around 600 vs. 1000?

He concluded that the inflation in 1974 was caused by - decades of world economic expansion and a shift in

economic leverage to resource - rich lesser developed countries, 10 years of accumulating domestic deficit spending, and a number of unique accidents (or misjudgments) in 1974 (including oil price increases, impact of environmental legislation costs, removal of wage/price controls, food cost increases and the resulting inflationary psychology).

He did not expect the same accidents to happen again, the lesser-developed countries will attempt to maintain or increase oil and other material prices, but most important, deficits will continue as social programs grow at a 15-20% rate. His most likely scenario, which is also his most optimistic, was for prolonged inflation at 5-7%, declining productivity and decreasing material prosperity.

He found for the 98 largest grocery manufacturers and 29 largest distributors:

- Between 1967 to 1973, 80% of grocery retail sales growth was from inflation, but between 1971 and 1973, inflation actually exceeded sales growth for both manufacturers and distributors.

- Improved EPS were due primarily to improved asset turnover resulting from inflated sales.

- Profits were overstated because of inflation since most firms were on a FIFO inventory basis.

- And there is a cash squeeze for the already highly leveraged industry, that will be further aggravated by inflation.

- And external funds, either debt or equity are either very expensive or unavailable.

This is a major issue - the ability to attract capital at reasonable rates.

ISSUE 3. Regulations - both Federal and state - but particularly state are a major issue that will continue. There appear to be some major questions of principle yet to be answered.

Should the many variations of state regulations on packaging and labeling be permitted, or should there be a common set of federal regulations (even at the expense of further centralization of power).

Is it necessary to protect humans from the potential danger from food additives, even at consumption levels that are physically impossible?

What criteria should be used for determining just how much competition is enough to protect the public and to maximize the efficiency of the system, (we have a good example in the financial community as a result of the SEC's ruling on negotiated rates).

The issues in this area of regulations can go on forever. But one element that appears to be missing is the approach of systems rather than individual issues or cases. I'll have more to say about this principle of "systems".

ISSUE 4. The trend toward "eating out" continues. The National Restaurant Association projects expenditures for away-from-home food will climb at about 9.5% annually in real dollars. The rate of increase will be highest for limited menu restaurants. The ratio of expenditures for food at home to away from home is expected to change from the current 3.5 to 1 to about 2.1 by the end of 1980 - and the physical distribution system for selling food through low volume restaurants is quite different than through supermarkets.

ISSUE 5. Since the depletion of our huge stocks of food and feed grains and the small corn crop of 1974/75 agricultural commodity prices have been on a volatile pattern that at times appeared to be of earthquake proportions. One result has been to rapidly accelerate the search for alternative food ingredients that potentially may impact the food industry structure in a major way.

An almost laboratory type example was what happened to the corn sweetener business when sugar prices sky rocketed in 1974. A relatively new product, High Fructose Corn Syrup had been struggling for about four years, gradually gaining acceptance as a direct substitute for liquid sucrose (sugar) in a variety of industrial uses. But with stable, and relatively low sugar prices, there was no strong incentive for industrial users to make the expenditures necessary to change formulas. HFCS, that had been selling at a 15% discount to sugar was selling at a 50% discount when sugar hit 60¢/lb. - and the race was on - to change formulas and to expand HFCS production capacity. Now that the industrial users have alternative formulas, they will be much more sensitive to relative prices. In fact, there are many other sweetener alternatives, and I expect the entire sweetener complex to be computerized for least-cost formulation just as was done for sausage formulation by the meat packers.

Vegetable proteins are another food ingredient group with great potential in combination with meats. They had an abortive leap for success when hamburger prices went out of sight last year, primarily because the product quality was inferior to the meats for which it was substituted. But now that the promised land is in sight, great efforts are going into R&D that undoubtedly will be successful in

improving product quality, and with their cost advantage, vegetable proteins will be a major factor in protein consumption. Although much slower to materialize than corn syrup, the impact will be much greater on the structure of our entire food manufacturing and distribution industry.

ISSUE 6. Food manufacturing and distribution has become so interrelated that it must be viewed and approached as a "group of systems". In the examples that I just used, the corn syrup and vegetable proteins are only "ingredients" to the feeding system that are packaged and distributed in unique ways. Electronic checkouts, retail backhaul, and the perishable distribution from the west coast as more obvious examples of need to approach the problems as systems and to move away from special consideration of our own small area of interest.

I have some personal involvement with retail backhaul that has received much attention during the past two years - beginning with its identification as an area for cost saving by the CLC. It received additional attention as a full saver during the energy crunch. It has such obvious potential because of the empty trucks passing on the highways, but its adoption has been slow. I believe that if we could have secured the cooperation of the FTC, justice, retailers, wholesalers and manufacturers to consider it in perspective to the total food distribution system, progress would have been quicker and with longer lasting results.

ISSUE 7. The last issue - that of our "legislative factory" in Washington - is one of my major concerns. The number of proposed bills is staggering, and particularly on top of special committee investigations and re-election campaigns. But, as with any executive, our Congressmen are forced to make a decision at

voting time on the basis of "available information". Unfortunately, what they have seems woefully inadequate for today's complex food industry. I see the challenge for anyone still retaining some reputation for objectivity, to provide politico-economic information - and I assume that includes all of you here today.

SUMMARY

An obvious bias of mine is that food distribution must be dealt with as an integral subsystem of the entire food industry. The food industry must improve its profit ability if it is to effectively compete for capital. Productivity in the usual context of labor/capital substitution is extremely important, but unless attention is given to potential innovations in food ingredient and similar related systems that may effect structural changes, some productivity improvements may not only be shortlived but also yield a low ROI. And of course, much of the progress could be negated by "well intentioned" federal and state legislation and regulation.

One thing is certain, the next several years will be exciting ones for the food industry.